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UNCLAS ANKARA 003662

SIPDIS

SENSITIVE

STATE FOR E, EB/IFD/OMA AND EUR/SE
TREASURY FOR OASIA - MILLS AND ADKINS
NSC FOR BRYZA AND MCKIBBEN

E.O. 12958: N/A
TAGS: EFIN PREL TU
SUBJECT: IMF, TURKEY EXPECT TO SIGN LOI FOR 8TH REVIEW NEXT WEEK

REF: ANKARA 3409

¶1. (SBU) IMF ResRep told us June 28 that the recently-completed Mission had resolved most outstanding issues, although the work was harder and took longer than expected. He predicted they would sign the Letter of Intent for the 8th Review next week, enabling the IMF Board to complete the review before it begins its summer holiday.

¶2. (SBU) Brekk said there were two substantive outstanding issues when the Mission departed. First, the GOT needed to agree to pass higher oil prices on to consumers, i.e., stop compressing the Petroleum Excise Tax to avoid passing on higher world prices. The government on June 29 announced a five percent increase in petroleum product prices. Second, the GOT had not been fully living up to its commitment to transfer Special Revenues (which in the past were earmarked) to the general budget. The end-June target was to transfer TL 1.3 quadrillion ($872 million), but the GOT had only transferred TL 600 million ($403 million) as of mid-June. After the Mission departed, the authorities transferred another TL 600 million, so they are now close to the end-June target. Brekk said the GOT clearly had been trying to take advantage of fiscal overperformance to spend more money (i.e., use these formly earmarked funds for spending outside the budget), but the Fund stopped this.

¶3. (SBU) In a June 25 conversation, Treasury U/S Canakci agreed the review had been more difficult than expected, in large part due to disagreements over the Petroleum Excise Tax and a GOT proposal to expand investment incentives. He added that the GOT and Fund had also discussed a GOT legislative initiative to cap municipal borrowing (previously limited only by Treasury's willingness to provide guarantees for external borrowing). The GOT had proposed capping borrowing at 200 percent of a munipality's annual revenue, but -- after the Fund weighed in -- agreed to reduce the cap to 100 percent of annual revenues.

¶4. (SBU) Brekk said they would have to plug in revised macroeconomic numbers to the LOI, based on GNP and inflation figures due to come out June 30. He predicted that the GOT would have to revise up both projected GNP growth and the current account deficit, which he acknowledged was becoming a concern. Canakci also acknowledged for the first time that, because of the growing current account deficit and large debt repayments, a financing gap was likely to emerge in 2005. He reiterated that the GOT had not yet decided whether to seek another IMF Stand-by, but said he understood from comments by Fund officials that the IMF would be willing to provide more lending if requested. Separately, AK MP Reha Denemec told us June 28 that, in economic terms, there was no doubt that Turkey needed additional IMF financing, but GOT officials were hesitant because of the perceived domestic political cost of pursuing that option.
EDELMAN